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Intersecretariat Working Group on National Accounts

Note by the Secretary-General

In accordance with a request of the Statistical Commission at its thirty-seventh session,** the Secretary-General has the honour to transmit to the Statistical Commission the report of the Intersecretariat Working Group on National Accounts. The Commission is requested to comment on the overall progress in the updating of the *System of National Accounts, 1993* (1993 SNA). The Commission is also requested to consider adopting the recommendations on the update of the 1993 SNA made by the Intersecretariat Working Group.

* E/CN.3/2007/1.

** See *Official Records of the Economic and Social Council, 2006, Supplement No. 4* (E/2006/24), chap. I, para. 2.

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Report of the Intersecretariat Working Group on National Accounts

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I. Introduction

1. At its thirty-seventh session, the Statistical Commission:

(a) Commended the progress made in the updating of the *System of National Accounts, 1993* (1993 SNA)[1] in the issues-oriented phase of the update process, as reflected in the report of the Intersecretariat Working Group on National Accounts (E/CN.3/2006/6), acknowledged the focused contributions and expertise provided by a wide range of countries and organizations to the work of that phase and expressed confidence in the Intersecretariat Working Group in maintaining the momentum in the drafting and review phases of the update process in 2006 and 2007;

(b) Attributed the commendable progress in the update of the 1993 SNA to the adoption of the project management approach and the extensive use of a transparent interactive website and recommended that approach and technology be applied in similar statistical projects and programmes;

(c) Welcomed the inclusion of a chapter on the measurement of informal sector activities in the revision of the 1993 SNA;

(d) Took note of the concerns regarding the treatment of unfunded government pension schemes and the need for continuing consultations on the recommendation of the Advisory Expert Group on National Accounts on that issue and expressed that it would welcome a timely resolution within the existing governance structure of the Working Group;

(e) Recommended that the Intersecretariat Working Group continue to include the treatment of government social services in its research agenda;

(f) Recognized the need for an adequate response to requests from Member States for assistance in capacity-building for the implementation of the revision of the 1993 SNA, and accepted the proposal by the Intersecretariat Working Group to prepare a programme of implementation to be available to the Commission by its thirty-ninth session.

2. Chapter II provides a report on progress since the thirty-seventh session of the Statistical Commission and looks ahead over the period that will end with the Commission's thirty-ninth session. Chapter III presents the recommendations for the update of the 1993 SNA that are before the Commission for its consideration and, if approved, their adoption. A background document, entitled *The Full Set of Consolidated Recommendations*, contains the recommendations made by the Advisory Expert Group on National Accounts. Points for discussion are contained in paragraph 54.

II. Progress on the update of the 1993 System of National Accounts

A. Background

3. In 2003, the United Nations Statistical Commission called for an update of the 1993 SNA to bring accounts into line with the new economic environment, advances

[1] United Nations publication, Sales No. E.94.XVII.4.

in methodological research and the needs of users. The Commission mandated that the update would not recommend fundamental or comprehensive changes to the 1993 SNA that would impede its implementation, that recommendations for change should consider feasibility of implementation and that consistency with related manuals should be an important consideration.

4. The Intersecretariat Working Group on National Accounts — comprising the Statistical Office of the European Communities (Eurostat), the International Monetary Fund (IMF), the Organization for Economic Cooperation and Development (OECD), the United Nations and the World Bank — was asked to organize and coordinate the update project, assisted in its work by the project manager and editor. The timetable, as agreed to by the Statistical Commission at its thirty-fifth session, calls for the draft *1993 SNA, Rev.1* to be ready for adoption by the Commission at its thirty-ninth session.

5. The Statistical Commission emphasized the need for the broadest possible involvement of the global statistical community in the update project and the Advisory Expert Group on National Accounts, comprising 20 country experts from all regions of the world, was established to play a key role in the update. The Advisory Expert Group considers proposals for change and expresses its views, both in meetings and in web-based written consultations. The project website, maintained by the United Nations Statistics Division at http://unstats.un.org/unsd/nationalaccount/snarev1.asp, promotes transparency and the wide involvement of national accounts experts. The website provides comprehensive and timely information related to the update, including the five-year work programme, the agreed list of update issues, related papers, recommendations of the Expert Group, comments by countries on the recommendations and links to related sites.

B. Progress since the thirty-seventh session of the Commission

6. At the time of the thirty-seventh session of the Statistical Commission, the project manager outlined several steps to make the transition from the issues-oriented phase of the project and to begin the drafting and review phase. Overall, the work has progressed as planned, with some aspects requiring more effort than envisaged a year ago and some taking less.

7. One challenge was to conclude the consideration of issues, while taking care to avoid new consideration of recommendations which had been completed. In accordance with the need expressed by the Commission for further consultation on the treatment of government unfunded pensions, consultations proceeded in several stages, leading to a compromise as described in chapter III. The winding up of work on contracts, leases and licences proved to be complex and required extensive consultation with the Advisory Expert Group. Those consultations and work on several points of consistency proved to be time-consuming and, therefore, it was not until early in October 2006 that a conclusion was reached on almost all of them.

8. The work programme adopted by the Commission at its thirty-fifth session called for a period of review of the consistency of the recommendations and the overall integrity of the System in 2006. The document entitled *Full Set of Provisional Recommendations* was the main vehicle to support such a review. The document, which was completed in April 2006, contains descriptions of the issues and the recommendations of the Advisory Expert Group as at that date. It was sent

to national statistical offices and interested central banks with an invitation to comment thereon by mid-September. It was posted on the project website in English, French, Russian and Spanish. To obtain further feedback, the document also served as the basis of discussion at several meetings, as described in paragraph 18.

9. The drafting of chapters began in earnest as the work on issues drew to a close. The main tool for tracking progress during the drafting and review phase is a chapter-by-issue matrix. The progress matrix was posted on the project website with the first draft chapters for comment by countries worldwide and the Advisory Expert Group early in October 2006. The colour of the entry for each chapter in the matrix indicates the current stage of that chapter as it goes from first posting for comment, revision and finally ready for consideration by the Statistical Commission. A key feature of the presentation of the draft chapters is the identification, in the matrix, of which of the 44 recommendations affect each chapter. It clearly identifies the due dates for country and Advisory Expert Group comments; timely comments will be essential if bottlenecks are to be avoided.

10. The long-term research agenda may be consulted on a page on the project website. It identifies topics related to the SNA that need to be explored but were considered to be outside the scope of the present update or were likely to take more time than was available. Although attention will be kept focused on completing the update on schedule, it is important to start planning and outlining the research and consultation that needs to be done in the future. Comments and proposals have been requested on the topics to be considered for long-term research.

C. Looking ahead

11. The drafting and review of chapters for the *1993 SNA, Rev.1*, is moving ahead according to the plan described earlier in 2006. The plan calls for the draft chapters — some 27 in all — to be divided into roughly two equal tranches so that work by the editor and reviewers can proceed in parallel. The first tranche comprises the chapters that might be called the heart of the SNA, mainly the chapters that cover the sequence of accounts from production to the balance sheet. As noted earlier, the first two of these chapters were posted on the project website for a 60-day comment period on 3 October 2006. Since then, more have been posted. Work on the chapters included in the second tranche will continue in 2007.

12. An Advisory Expert Group meeting is planned for 19-23 March 2007, hosted by the United Nations Economic Commission for Africa. The timing was planned so that the meeting would have the benefit of the reactions of the Statistical Commission to the recommendations. The main agenda item will be on draft chapters, drawing on the Commission's reactions to the recommendations and comments received from countries and Advisory Expert Group members on the draft chapters. Other agenda items will include proposals for manuals to support the SNA, opening consideration of the topic of general implementation and early organizational steps on the long-term research agenda. A second Advisory Expert Group meeting is planned towards the end of 2007 to deal with the second tranche of chapters and more on implementation.

13. The Intersecretariat Working Group, in addition to its overall role as a coordinating body, will continue to support the editor by reviewing drafts and by

researching and helping to reach conclusions on points that come up in the drafting, consulting the Advisory Expert Group as appropriate. The United Nations Statistics Division will continue to provide secretariat services and to maintain the project website, where it is likely that attention will focus on the progress matrix that details the work and due dates for comments on the draft chapters. The attention of the Intersecretariat Working Group will increasingly turn to implementation of the recommendations, with a view to delivering on its commitment to present an implementation strategy to the Commission at its thirty-ninth session.

III. Recommendations for the update of the 1993 System of National Accounts

A. The process of reaching recommendations

14. An initial list of issues to be considered in the update was drawn up by the Intersecretariat Working Group. That list, which included issues that had been on the research agenda presented in the *System of National Accounts, 1993* and some that had surfaced later, was endorsed by the Statistical Commission at its thirty-fourth session. The Commission asked that the list be kept open-ended for further proposals, subject to approval by the Advisory Expert Group. The Advisory Expert Group discussed the list at its first meeting in February 2004, and, after some consolidation, the agreed list of 44 issues has provided the framework for the scope of the research undertaken, the discussion and consultations carried out and, ultimately, the recommendations being made. As noted above, issues that have arisen but which are beyond the scope of the update have been referred to the long-term research agenda.

15. As set out in the work programme approved by the Statistical Commission, the consideration of issues proceeded in steps. First, issues were researched and discussed in topical expert groups. Those groups included the Canberra II Group on Non-Financial Assets, the Task Force on the Harmonization of Public Sector Accounts, the IMF Committee on Balance of Payments Statistics, the Task Force on the Valuation and Measurement of Equity, the Task Force on Financial Services, the Expert Group Meeting on Industrial Statistics and several special-purpose electronic discussion groups and task forces (for example, on pensions). The groups prepared issues papers, including recommendations, for the Advisory Expert Group to consider. The Advisory Expert Group met four times from 2004 to 2006, discussing and making recommendations on each of the 44 issues. Some issues were relatively simple, with a limited impact on accounts and on the text, but some were complex. A number of them were discussed by the Advisory Expert Group several times, progressively following up on questions and filling in details to reach a recommendation.

16. After each meeting, the Advisory Expert Group's recommendations were sent to national statistical offices and interested central banks, with an invitation to them to comment thereon. In all, comments were received from almost 100 countries. From 40 to 60 countries commented after each round of recommendations. The comments, which are posted on the project website, provide a rich source of information on why countries supported the recommendations or, in some cases, why they did not; their views on implementation of the recommendations; and ideas

about the kind of guidance they would hope to find in the updated SNA. In depth and breadth, the country involvement has been noteworthy. Thanks to technology and concerted efforts by all concerned, more is known about countries' views at the current stage than has ever been known about an international project of a similar scope.

17. The dissemination, in April 2006, of the document entitled *Full Set of Provisional Recommendations*, opened a five-month period for comments on all the recommendations taken as a whole, especially on the internal consistency of the recommendations and the integrity of the resulting System.

18. Throughout the period of formulating and reviewing the recommendations, a number of workshops and meetings provided opportunities to inform participants about the ongoing update and to debate the issues. Many were regional but some were broader in their participation. The following is only a partial list but it suggests the different kinds of forums in which the Intersecretariat Working Group, project manager, editor and some Advisory Expert Group members participated as part of the outreach effort:

(a) In collaboration with the United Nations regional commissions, regional workshops on the 1993 SNA update were held for national accountants in the Asia-Pacific region in April 2005, in Latin America and the Caribbean in October 2005 and August 2006, in Africa in November 2005 and in Western Asia in December 2006;

(b) The joint United Nations Economic Commission for Europe/Eurostat/OECD meeting of national accountants in April 2006 focused on issues related to updating the SNA. It had before it the *Full Set of Provisional Recommendations* during its discussions;

(c) The Delhi Group on Informal Sector Statistics discussed the proposed chapter in the updated SNA, on the informal sector, in May 2006;

(d) The United Nations Statistics Division held a seminar on the creation, recognition and valuation of intellectual assets in New York, in July 2006. The participants were academics, business accountants and national accountants;

(e) The annual meetings of the OECD Working Party on National Accounts provided a forum for a debate on key issues in the update;

(f) The European Central Bank hosted a meeting with data users following the Advisory Expert Group meeting in Frankfurt, Germany, in February 2006;

(g) A session on the SNA update was included in the Forum for Asia-Pacific Statisticians, the meeting of heads of national statistical offices in the region, in September 2006. That session, in addition to discussing key recommendations, began exploring an implementation strategy.

B. Overview of the recommendations

19. The recommendations of the Advisory Expert Group for updating the 1993 SNA are presented in a separate background document entitled *The Full Set of Consolidated Recommendations* (*Consolidated Recommendations*). That document includes complete recommendations where consultations were still in progress when

the *Full Set of Provisional Recommendations* was prepared. It also includes selected clarifications.

20. As can be seen from the descriptions of issues in the *Consolidated Recommendations*, the motivations to consider the agreed issues were diverse. The reasons included the need to design treatments for units and transactions that arose or became more prominent since the 1993 SNA was completed, to remove inconsistencies in the 1993 SNA, to harmonize the 1993 SNA with other manuals in the field of macroeconomic statistics and to proceed with the research agenda left at the end of the process leading up to the 1993 SNA. The recommendations cut across almost all parts of the SNA, but they are concentrated in parts that deal with non-financial assets, financial services and financial instruments, the rest of the world (balance of payments) and government and the public sector. In other words, the majority of the recommendations relate to units and transactions that represent characteristics of an increasingly globalized economy; come from increased interest in the sources of wealth and debt; recognize the increasing role of intangible non-financial assets; take into account further innovation in financial markets; reflect the interest in better measures of the impact of pension liabilities in the context of an ageing population; and recognize the need for better measures of government and public-sector debt and deficit. Some of the recommendations affect major aggregates of the System, such as gross domestic product and savings, as would be expected of an update intended to capture the evolving aspects of production, consumption and accumulation. Many other recommendations do not affect the major aggregates but reflect a range of other elements, including elaborations and clarifications of definitions and classifications.

21. Two features of the recommendations deserve special attention in light of the interest expressed by the Statistical Commission. First, the recommendations reflect the successful efforts to harmonize the SNA and other international statistical standards and manuals. Most striking is the close coordination of the update of the 1993 SNA and the revision of the *Balance of Payments Manual, Fifth Edition*.[2] The two projects are proceeding on roughly similar schedules, and this allowed issues that cut across the two areas to be considered by both groups. When feasible, the editors of the two manuals participated at the other project's meetings and they have been in close contact to agree on definitions and the like. Both the IMF *Government Finance Statistics Manual*[3] and the *Monetary and Financial Statistics Manual*[4] were already harmonized with the 1993 SNA. Throughout the update, close attention was paid to further harmonization with these manuals and the *Integrated Environmental and Economic Accounting, 2003*.[5] Similarly, close coordination was carried out to maintain consistency with the major classification systems. For example, as a clarification — but an important one — an agreed structure for the high-level presentation of industries in the SNA was worked out that was consistent with the *International Standard Industrial Classification of All Economic Activities, Rev.4*.[6]

22. Second, the recommendations, when appropriate, draw upon international standards for business and public accounting. Every effort was made in researching

[2] Washington, D.C., IMF, 1993.
[3] Ibid., 2003.
[4] Ibid., 2000.
[5] Studies in Methods, Series F, No. 61, Rev.1.
[6] United Nations publication, Sales No. E.03.XVII.4.

the issues to take into account the existing and emerging standards of the accounting community, particularly those of the International Accounting Standards Board and the International Public Sector Accounting Standards Board. That is particularly important because of their increasingly international application. Examples of recommendations that are supported by accounting standards are those for mineral exploration, non-performing loans and military expenditures.

C. Results of the consultations on the provisional recommendations

23. The consultations show unanimous or near unanimous support for almost all of the provisional recommendations of the Advisory Expert Group. The near unanimous support now extends to one issue, pension schemes, that a year ago led the Statistical Commission to note that further consideration of government unfunded pensions was needed. As a result of subsequent consultations, a solution emerged that is now widely accepted and incorporated in the *Consolidated Recommendations*. A key feature of the solution is that the updated SNA would include an additional standard table on pensions. That table would show all flows and stocks of the pension entitlements for all pension schemes. Such a table would make cross-country comparisons of financial aspects of pensions possible while still allowing flexibility in how far the pension entitlements conveyed by the schemes are reflected in the core accounts. Given the different institutional arrangements in different countries, the updated SNA will permit recording only some of those pension entitlements in the core accounts. However, it will be a requirement that the rationale and criteria be provided to explain the distinction between those schemes whose entitlements are carried forward to the core accounts and those for which they are recorded only in the new standard table.

24. On five issues, however, there was significantly less than unanimous support, and that situation called for especially careful consideration by the Intersecretariat Working Group of the extent of the disagreement, the reasons for the disagreement and the possibility that further consultation might lead to some resolution. For those issues, the description and recommendation of the Advisory Expert Group, the comments received — in favour and in disagreement — during the consultation period, and the issue-specific considerations of the Advisory Expert Group are set out below to facilitate their consideration by the Statistical Commission.

Research and development (issue 9)

25. *Description and recommendation of the Advisory Expert Group*: The 1993 SNA does not recognize research and experimental development as capital formation, despite the fact that it is thought to be a major contributor to future economic growth. Were the SNA to be changed, consideration is required of whether all expenditure on research and development, or only some, should be recorded as capital formation. To overcome all the practical difficulties of deriving satisfactory estimates, the possibilities of using expenditure data collected in accordance with the *Frascati Manual 2002: Proposed Standard Practice for Surveys on Research and Experimental Development*, and obtaining appropriate deflators and service lives, need to be assessed.

26. The recommendation is that research and development should be treated as capital formation and the value should be determined in terms of the economic

benefits it is expected to provide in the future (including the provision of public services in the case of research and development acquired by Governments). In principle, research and development that does not provide an economic benefit to its owner does not constitute a fixed asset and should be treated as intermediate consumption. Unless the market value of the research and development is observed directly, it may be valued at the sum of costs, including the cost of unsuccessful research and development.

27. *Consultation on the recommendation*: A substantial majority of countries expressed support for the recommendation on the capitalization of research and development. The view was expressed that implementation of the recommendation would improve studies of growth and productivity. While a number of countries expressed their agreement with the principle, they also expressed concerns about one or more aspects. In their comments, some countries noted the difficulty of distinguishing those research and development expenditures that should not be capitalized because ownership is not established or future returns could not be identified. Others voiced reservations regarding the practical implementation of the recommendation, including the difficulty of working with accounting and survey-based data. Several suggested the need for detailed guidance.

28. Those who expressed disagreement with the recommendation did so on both conceptual and practical grounds (besides objecting to inclusion of the issue on the agreed list). A few comments state that expenditures are a poor proxy for the benefits brought by research and development, and several mention practical problems such as determining service lives and/or identifying appropriate price indices of the research and development assets. Those countries that stressed the need for compilation experience seem to suggest that a delayed implementation was a way towards eventually including research and development expenditure within the asset boundary of the System.

29. *Considerations of the Intersecretariat Working Group*: The country comments indicate that there is substantial support for the principle of capitalizing research and development in the SNA. There are some concerns, however, about specific aspects. Those include scope, service lives and price indices for research and development assets. Subsequent to the provisional recommendation, there were further consultations about scope (centring on what is known as freely available research and development), and those led to the recommendation in the *Consolidated Recommendations*. Further, some regional meetings continued to discuss this issue.

30. The Intersecretariat Working Group is confident that the combination of countries' experience and ongoing research (as represented, for example, by the papers presented at the October 2006 meeting of the OECD Working Party on National Accounts), further collaboration between the Canberra II Group and the research and development survey statisticians and further consultations by the United Nations Statistics Division with the corporate sector, academic and international accounting community can resolve the problems in the future. Thus, the Intersecretariat Working Group puts forward the following wording designed to adopt the principle of treating research and development expenditure as fixed capital formation and to encourage focused work to implement the principle in a sound and internationally comparable way:

In principle, research and development expenditure should be recognized as part of capital formation. However, there are a number of difficulties to be overcome before the objective can be reached. Satellite accounts will provide a useful way of working towards solutions that give the appropriate level of confidence in the resulting measures and practical guidance on implementation will help to ensure international comparability. Therefore, the *1993 SNA, Rev.1* will describe the objective and its conceptual underpinnings, note the difficulties and provide links to work underway to overcome them and recognize that for many countries implementation will take some time. The Intersecretariat Working Group will report periodically to the Statistical Commission on progress and signal when widely accepted implementation guidelines are available.

Cost of capital services (issue 15)

31. *Description and recommendation of the Advisory Expert Group*: Capital services provided by non-financial assets to the production process are not explicitly mentioned in the 1993 SNA. The OECD manual entitled *Measuring Capital: Measurement of Capital Stocks, Consumption of Fixed Capital and Capital Services*, published in 2001, defines capital services as inputs that flow to production from a capital asset. They may be estimated as the sum of consumption of fixed capital, expected real holding gains/losses and a return to capital, similar in value to the cost of interest on the remaining value of the asset. The rental paid by the user of a rented non-financial asset to the owner covers both the costs incurred by the owner in providing the rental service and the capital services rendered by the asset to the owner. For non-financial assets used by the owner, capital services appear implicitly as part of the gross operating surplus.

32. The recommendation begins by noting that capital services for assets used in market production are implicitly included within the 1993 SNA but are not separately identified. Given the importance of identifying them for productivity measurement and other analysis, a new chapter will be added to the *1993 SNA, Rev.1* explaining the role and appearance of capital services in the system and stressing the desirability of calculating capital services, capital stock and consumption of fixed capital in an integrated and consistent manner. No changes will be made to standard entries in the accounts to show capital services but an explanation will be provided of how supplementary items or tables could be derived and presented.

33. *Consultation on the recommendation*: Overall, there was substantial support for the recommendation; disagreement was limited to only a few countries. However, a number of comments were hard to interpret. Some stressed that the estimates of capital services should be optional, voluntary or presented only in satellite accounts, and it is not clear that the intent of the recommendation to treat them as optional was understood.

34. Of the few countries that disagreed, some mentioned (besides objecting to inclusion of the issue on the agreed list) the negative effect on international comparability of the somewhat arbitrary choice of a rate of return.

35. *Considerations of the Intersecretariat Working Group*: The Intersecretariat Working Group notes the almost unanimous support for the recommendation on cost of capital when it is understood, as intended, that the identification of the cost of

capital for market producers is not called for in the core accounts and that it is voluntary within the recommended supplementary accounts. The Intersecretariat Working Group thus puts forward for adoption the recommendation incorporated in the *Consolidated Recommendations*.

Government and other non-market producers: cost of capital of own assets (issue 16)

36. *Description and recommendation of the Advisory Expert Group*: When summing costs to measure non-market output, the 1993 SNA recommends that the value of the services provided by a producer's own non-financial assets should be measured as consumption of fixed capital. Neither a return to capital on these assets or, equivalently, an opportunity cost of capital is recognized. That gives rise to an inconsistency between the costs of owned and rented assets to the non-market producer.

37. The Advisory Expert Group recommended, after extensive discussion at three of its meetings, that a return to fixed capital owned and used by government and other non-market producers be included in the estimation of output in addition to consumption of fixed capital. The restriction to fixed capital is a compromise with a view to practical implementation. For the rate of return, the expected real rate on government bonds is recommended, supplemented if necessary by other indicators of the cost of borrowing by government.

38. *Consultation on the recommendation*: Comments after the early Advisory Expert Group discussions led to the specification in the recommendation of the scope of the assets (fixed assets) and a rate of return to be used (expected real rate on government long-term bonds). The more recent comments showed that more countries are comfortable with the recommendation. Agreement came from a wide range of countries. Several comments noted the consistency with the market sector that would come about as a result of implementing the recommendation and that users' analytical needs would be met. Some, from both large and small countries, reported that they could produce estimates of capital services of a reasonable quality. A number of comments were in favour of the recommendation in principle, but were concerned about implementation, some indicating the kind of guidance that they would like to see provided in manuals.

39. Disagreement with the recommendation also came from a range of countries but was concentrated in Europe. Some disagreement was on conceptual and some on practical grounds. Some comments were lengthy and detailed; the following points were common to several sets of comments: market and non-market production are different and the difference should be reflected in the method of measuring output; implementation would lead to more estimates based on modelling rather than observation, and that should be avoided; for many countries, the required estimates of capital stock are not well developed, so even estimation of consumption of fixed capital is difficult; and identifying appropriate rates of return is problematic and would lead to additional non-comparability among countries.

40. *Considerations of the Intersecretariat Working Group*: The Intersecretariat Working Group has taken note of the views expressed in the course of the last year on the issue, which has engaged theorists, users and national accounting practitioners over several decades. The issue is complex and the discussion evolved as the complexities were set out in the Advisory Expert Group's meetings during the

update's issue-oriented phase. Since then, the process of stepping back to review the set of recommendations as a whole has focused attention on the consistency of the treatment of financial and non-financial assets. The review has brought an added dimension. To bring this consistency dimension to the Advisory Expert Group for its consideration and to get its advice in light of the differences of view as expressed in the country comments on the Advisory Expert Group recommendation, the Intersecretariat Working Group is undertaking an electronic consultation among the Advisory Expert Group members. The consultation will be the basis of further Intersecretariat Working Group consideration of the way forward, which will be presented in a conference room paper to be prepared as a supplement to the Intersecretariat Working Group's report to the Statistical Commission.

Military expenditures (issue 19)

41. *Description and recommendation of the Advisory Expert Group*: In the 1993 SNA, offensive weapons and their means of delivery are excluded from capital formation regardless of the length of their life. That treatment implies that military assets provide defence services only and entirely in the period of acquisition. Further, weapons whose expense has been expressed as intermediate consumption, according to the present treatment, can be sold or exported in another accounting period, calling for counter-intuitive entries in the accounts for government.

42. The recommendation is that all military expenditure that meets general SNA criteria for capital formation — that is, being used in production over a period in excess of one year — will be treated as capital formation. Weapon systems and military inventories would be distinguished within fixed capital formation and inventories, respectively.

43. *Consultation on the recommendation*: Some comments noted the difficulty of implementing the 1993 SNA treatment, which calls for distinguishing military equipment that can be put to civilian use. Several comments favoured the recommendation because it would bring national accounts into line with the way Governments recorded military expenditure (which, in turn, was in line with international public sector accounting standards). In a similar vein, it was noted that the recommendation eliminates an inconsistency in the 1993 SNA in that not all assets are included that contribute to the delivery of defence services.

44. Of the comments disagreeing with the recommendation, a number expressed concern about the lack of data given the confidential nature in many countries of information on military expenditures. If some countries had the necessary data to make estimates and others did not, international comparability would be undermined. Other comments were conceptual, elaborating on the argument that expenditure for defence purposes does not generate production of services.

45. *Considerations of the Intersecretariat Working Group*: The Intersecretariat Working Group considers that the accounting principles underlying this recommendation are important. The lack of data in some countries is indeed a concern but the recommendation that weapons systems should be considered capital assets in international public accounting standards should be recognized. To the extent that the problem is that data are not available, this is a deficiency in the measurement of government output, whether the weapons are treated as intermediate consumption or capital formation. Since the first publication of the SNA in the late 1950s, changing political circumstances have led to the recognition that capital

expenditures on offensive weapons render services by their existence rather than only by their use. The Intersecretariat Working Group acknowledges that the views on the recommendation differ. However, it considers that the recommendation included in the *Consolidated Recommendations* should be adopted to maintain the analytical relevance of the SNA in a changing global security environment.

Goods for processing (issue 40)

46. *Description and recommendation of the Advisory Expert Group*: Both the 1993 SNA and the *Balance of Payments Manual* treat goods that are sent abroad for processing and then returned to the country from where they were dispatched as undergoing an effective change of ownership. The goods are therefore recorded in exports and imports when they leave the first country and again when they return to it. The country undertaking the processing is shown as producing goods that are recorded at their full value, even though the processor never has to pay for the value of the goods on entry. With the increasing importance of offshore processing, such treatment is increasingly questionable. It is further complicated by a different recommendation for goods being processed in one country for a second which, instead of being returned to the second country, are sold (on behalf of the owner in the second country) to a third country.

47. The recommendation is that imports and exports should be recorded on a strict change of ownership basis. That is, goods being processed in one country on behalf of another would no longer be part of imports and exports in the balance of payments and SNA. That would be a change from the 1993 SNA. The consequences affect the recording of transactions within the national economy as well as international transactions. The decision to record on a pure change of ownership basis implies that no transactions will be recorded for intra-enterprise (inter-establishment) deliveries when goods are passed from one country to another for processing and then returned. That has implications for the input-output tables, which on the proposed basis will reflect what each unit contributes to the production process rather than the physical technology, as previously was the case. This recommendation recognizes that many goods move from one country to another without entailing a consequential payment from the recipient country to the sending country. The recommendations have implications for the way in which the physical movement of goods, captured in merchandise trade statistics, is reconciled with the international flows to be recorded in the balance of payments and the SNA. The IMF Committee on Balance of Payments Statistics was in favour of the recommendation.

48. *Consultation on the recommendation*: Comments were received in two rounds of global consultations, following the discussion of the issue at two meetings of the Advisory Expert Group. A substantial number of countries supported the recommendation but few gave their reasons why. Harmonization with the balance of payments treatment was mentioned, as was a preference for following the change of ownership principle. However, comments noted practical problems in determining changes in ownership of the goods. Several comments indicated the need for guidance in identifying and recording such goods in international merchandise trade.

49. Disagreement with the recommendation is spread across regions. Several comments are concerned by the difficulty of matching the transformed goods on exit

with the goods as they return to ensure the correct adjustments are made to merchandise trade figures. Some countries would prefer to continue to impute change of ownership. One other mentioned disruption in the historical time series of input-output tables with the change of principle of recording.

50. *Considerations of the Intersecretariat Working Group*: The Intersecretariat Working Group recognizes that the recommendation affects the balance of payments and input-output accounts as well as national accounts, but sees it as an important step towards recording that will shed light on a kind of transaction that is increasingly important in a globalized economy. Guidance on issues of data collection and reconciliation with data sets that are useful in their own right will be a key. In that light, the Intersecretariat Working Group considers that the recommendation should be adopted.

D. Summary of the considerations of the Intersecretariat Working Group on National Accounts

51. In addition to the issue-specific considerations noted above, the Intersecretariat Working Group took into consideration several general, interrelated factors expected to affect the reception that may be accorded the recommendations for the update of the 1993 SNA. One factor is that national statistical offices and other statistical units that prepare national accounts often face budget constraints and increasing demands that require careful scrutiny of proposals that are a drain on resources. Another factor is that one of the demands is for international comparability of statistics, which, certainly in some parts of the world, has become a driving force. Yet another factor is the greater awareness of several elements related to implementation. One element is the awareness of the need for practical and sometimes even detailed guidance on implementation to supplement the SNA's general framework of the SNA. Reference is sometimes made to the different ways in which the recommendation to capitalize software was implemented in the 1990s and the effect that those differences had on the international comparability of certain key aggregates. Another element is the awareness of the different potential implementation schedules in different parts of the world, as is evident from a survey conducted by OECD.

52. The Intersecretariat Working Group carefully reviewed the country comments. It reached the conclusion that the set of recommendations it is bringing to the Statistical Commission is crucial to maintaining the relevance of the SNA for analysis and for policy formulation and monitoring. The Intersecretariat Working Group had been aware of the importance of guidance on implementation, and the comments from countries on the provisional recommendations firmly underlined that. The Intersecretariat Working Group is committed to providing that guidance; indeed, some work is already under way, for example in exploring what kinds of manuals may be needed to support SNA implementation. Further, the Intersecretariat Working Group confirms its intent to bring a strategy for implementation to the thirty-ninth session of the Commission, when the draft *1993 SNA, Rev.1* will be proposed for adoption by the Commission.

53. Thus, the Intersecretariat Working Group asks the Commission to adopt the recommendations as set out in the background document entitled *The Full Set of*

Consolidated Recommendations with the additional considerations on five issues described in section III.C, summarized as follows:

(a) **Research and development**: The Intersecretariat Working Group proposes adoption of the principle of treating research and development expenditure as fixed capital formation and the encouragement of focused work to implement that principle in a sound and internationally comparable way. The Intersecretariat Working Group will report periodically to the Statistical Commission on progress and indicate when widely accepted implementation guidelines are available;

(b) **Cost of capital services**: The Intersecretariat Working Group proposes for adoption the recommendation incorporated in the *Consolidated Recommendations* with the understanding that the identification of the cost of capital for market producers is voluntary within the recommended supplementary accounts;

(c) **Government and other non-market producers: cost of capital of own assets**: The Intersecretariat Working Group is undertaking electronic consultation among members of the Advisory Expert Group that will be the basis of further consideration by the Intersecretariat Working Group of the recommendation to be provided to the Commission in a separate conference room paper as an addendum to the present report;

(d) **Military expenditure**: The Intersecretariat Working Group considers the accounting principles underlying the recommendation to be important and the recommendation in the *Consolidated Recommendations* should be adopted to maintain the analytical relevance of the SNA in a changing global security environment;

(e) **Goods for processing**: The Intersecretariat Working Group sees the recommendation in the *Consolidated Recommendations* as an important step towards recording a kind of transaction that is increasingly significant in a globalized economy and considers that the recommendation should be adopted.

IV. Points for discussion

54. **The Commission is requested to:**

(a) **Comment on the progress in the update of the 1993 SNA and the workplan for the completion of the draft *1993 SNA, Rev.1*;**

(b) **Adopt the recommendations contained in *The Full Set of Consolidated Recommendations* with the considerations of the Intersecretariat Working Group on the recommendations on five issues elaborated in section III.C and summarized in section III.D of the present report and provided in a separate conference room paper as an addendum to the present report.**